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features

Cal-Mortgage Program Addresses Credit Concerns

Recent events relating to the California Mortgage Loan Guarantee Program (Cal-Mortgage) continue to demonstrate California's commitment to the program while underscoring the challenges inherent in Cal-Mortgage's speculative portfolio. In August 1996, Standard & Poor's upgraded Cal-Mortgage insured bonds to 'A+' from 'A,' following the upgrade of California. The ultimate guarantee of payment on Cal-Mortgage insured bonds is the full faith and credit of the state. Therefore, the rating applied to all debt insured through the program matches California's 'A+' rating.

Credit concerns raised by Standard & Poor's in 1993 regarding ambiguities in the program's structure have been methodically addressed by legislative changes. This should alleviate certain concerns frequently expressed by investors about the program's structure. However, the bankruptcy of Triad Healthcare in 1993 and subsequent financial distress of several other credits in the Cal-Mortgage portfolio have led to more than $30.8 million in payments to bondholders from Cal-Mortgage's Health Facility Construction Loan Insurance Fund (HFCLIF) since 1992. With the rapid changes in the health care industry, and the questionable future of such funding sources as Medicare and Medicaid, Cal-Mortgage has focused its efforts on evaluating the underlying credit strength of facilities in its portfolio, and on defining the future direction of its program.

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The Program

The Cal-Mortgage program, since its inception in 1968, has helped health care facilities in California gain access to the tax-exempt financing markets at borrowing costs comparable to the state's. The low credit quality characteristics of these facilities would normally create barriers to acquiring affordable capital. Although the bonds are guaranteed by the HFCLIF, the ultimate backing for the loans is the state's full faith and credit. Additions to the HFCLIF come from the 0.5% premium charged to the facilities each year for the amount borrowed, from interest income obtained through investment of the fund with the state treasurer, and from the up-front fees charged for new business.

The Cal-Mortgage program requires a debt service reserve to be funded at closing for each enhanced debt issue. This reserve, along with the HFCLIF, are the only financial resources available to offset payment deficiencies in the portfolio prior to any state involvement. At the program's request, the state will issue debentures on par with the state's general obligation and at the same interest rate as the original bonds. This is why the rating applied to all Cal-Mortgage enhanced debt is identical to the general obligation rating of the state.

Credit Concerns and Recent Changes

Standard & Poor's original comprehensive review of the Cal-Mortgage program (*see July 19, 1993, CreditWeek Municipal*), raised credit concerns of the state's ability and willingness to absorb future claims under the program. Standard & Poor's cited the poor credit quality and lack of geographic diversification of the portfolio, an ambiguous mechanism to replace failed bonds with state debentures, diversion risk of the HFCLIF funds for other state purposes, and bankruptcy risk. Although the HFCLIF as a percentage of enhanced debt has increased slightly, it continues to remain under-funded when compared to traditional bond insurer requirements. However, unlike traditional bond insurers, the Cal-Mortgage program is backed by the full faith and credit of

California Mortgage Program Rated Financings

California Health Facilities Authority Issues	Principal outstanding (mil. $)
AIDS Healthcare Foundation	5.5
Airport Marina Counseling	0.7
American Baptist Homes of the West series 88	33.4
Asian Community SNF	2.8
Association for Retarded Citizens	8.1
Becoming Independent	1.6
California Autism Foundation	4.6
Cedarknoll-Casa De Las Campanas	26.0
Clinica Popular Salinas	0.5
Clinicas Del Camino Real	2.6
Commty. Mental Hlth./Social Svc. Provider (Prototypes Womens Center)	2.4
Desarrollo Familiar	0.1
Episcopal Homes Foundation-San Francisco Towers	90.8
Eskaton Village Phase II	16.3
Exceptional Children's Foundation	2.9
Feedback Foundation/Olive Crest/Heritage House pool	5.5
Fellowship Homes (Casa De Modesto)	6.1
Foothill Presbyterian Hospital	6.7
Friends Assn. of Svcs. for the Elderly (Friends House)	2.8
Gardner Health Center	1.1
H.E.L.P. Group	9.1
Henrietta Weill Memorial	1.3
Henry Mayo Newhall Memorial	36.8
Hope Rehabilitation Service	6.0
La Palma Hospital Medical Center	25.2
Los Medanos Community Hospital	10.3
Madera Community Hospital	8.2
Marshall Hospital	35.5
Mercy Senior Housing (Mercy McMahon Terrace)	8.4
Mexican American Community Svcs. Agency	1.4
Nipomo Community Medical Center	0.7
On Lok Senior Hlth. & Community Hsg.	13.1
Porterville Family Hlth. Care Network	2.8
Sacramento Medical Foundation (Blood Center)	8.9
San Diego Christian Foundation (Canyon Villas Retirement Community)	8.1
Santa Barbara Medical Foundation	13.7
S. California Presbyterian Homes	36.6
Solvang Lutheran Home	5.2
South Coast Medical Center	13.3
Small Fac. Pooled Loan prog. ser. A Phase II	17.4
Small Fac. Pooled Loan prog. ser. B Phase II	19.1
St. Luke Manor	1.3
St. Paul's Episcopal Home Inc.	6.7

California Mortgage Program Rated Financings	
California Health Facilities Authority Issues	**Principal outstanding (mil. $)**
Thessalonika Family Services	1.3
Valley Care Hospital Corp.	44.7
Valley Memorial Hospital	11.6
Victor Valley Community Hospital	9.6
Walden House Inc.	8.3
California Statewide Community Development Authority Issues	
AIDS Project-Los Angeles	$ 9.5
Cal Lutheran Homes-Carlsbad by the Sea	37.3
California Lutheran Homes	15.7
Eastfield Ming Quong	6.6
Eskaton Properties	47.4
FACT Retirement Svcs. - Villa Gardens ser. 1997	9.4
FACT Retirement Svcs. - Villa Gardens ser. A	18.9
Families First	10.0
Kiero Nursing Home	10.1
Odd Fellow Housing of Napa (The Meadows of Napa)	19.0
Pacific Homes	50.0
Retirement Housing Foundation (Gold Country RHF-Bixby Knolls)	28.4
San Gabriel Valley Medical Center	49.0
S. California Devel. Corp. - VOA	3.5
Triad Healthcare	166.3
Villa View Community Hospital Inc.	14.3
Local Issues	
ABAG Fin. Auth. (Asian Health Services)	$ 6.5
ABAG Fin. Auth. (North Country Hlth. proj. (San Marcos Comm Hlth. Ctr.)	5.5
ABAG Fin. Auth. (Family Hlth. Foundation of Alviso)	4.9
Alhambra (Atherton Baptist Homes)	9.6
Apple Valley Hlth. Fac. (Apple Valley Retirement Care Center)	8.0
Bay Area Govt. Assoc. (A.C.C. - Miramonte Mental Hlth. Svcs.)	2.5
Bay Area Govt. Assoc. (Big Valley Med. Ctr./Janus Foundation/ S. Bay Alc. Svcs.)	2.9
Bay Area Govt. Assoc. (C. Cal. Comp. Drug/Sequoia Commty. Hlth./ Drug Abuse Alt. Ctr.)	4.2
Bay Area Govt. Assoc. (Channing House)	9.1
Bay Area Govt. Assoc. (Salem Lutheran Homes)	8.2
Chico Redev. Agency (Walker Senior Hsg (Sierra Sunrise Lodge))	19.3
Corcoran Hospital District	1.4
Cupertino (Sunny View Lutheran Home)	4.2
Eden Twp. Hospital District (Baywood Court)	22.2
Escondido (Redwood Terrace)	13.7
Fallbrook Hospital District	4.2

the state. While specific concerns related to the portfolio will likely remain, Cal-Mortgage has addressed ambiguities regarding the issuance of debentures and diversion risk.

In June 1994, state and program officials formalized a memorandum of understanding between Cal-Mortgage and state agencies that described the procedure to transfer funds from HFCLIF to the bond trustee when needed. In August 1996, a memorandum of understanding was formalized describing the procedure to identify credits in the portfolio that may require debenture issuance and the process that must be followed to effectuate such issuance. Furthermore, the concern regarding the possibility that the state legislature might use the fund as a "quick fix" for a budget shortfall was addressed by the legislature with the passage of Senate Bill 1705 in September 1994. This bill ensured that these funds could only be used for purposes relating to Cal-Mortgage. It also clarified that in the event debentures were issued, they would be paid on par with the state general fund obligations. Finally, bankruptcy risk (preferential payments) remains, but Standard & Poor's has concluded that the program structure renders this risk remote with no rating impact.

Status of the Portfolio

In addition to the legislative and contractual changes, Cal-Mortgage has taken steps to mitigate risks associated with the speculative portfolio, and to manage existing and potential defaults. Cal-Mortgage has reduced total insured project risk from $2.1 billion from 1992 through 1995, to $1.8 billion in 1997, and now approves a much smaller number of projects on an annual basis than in prior years. The HFCLIF currently is funded at $137 million, representing 7.4% of total debt backed by the program. This percentage has increased from 6.4% in 1995, due to the addition of $7 million to the HFCLIF and the decrease in the size of Cal-Mortgage's loan portfolio. With an additional $142.6 million from the debt service reserve funds of each facility, the total amount of reserves compared to total enhanced debt is 15.1%. The most recent actuarial report, prepared by William M. Mercer in late 1995, reported that the HFCLIF appeared to be sufficient to meet all "normal and expected" expenses, including the ongoing expense of the Triad default. To date, Cal-Mortgage has paid $23.3 million from the HFCLIF for debt service and principal payments on the Triad bonds.

The Triad default and bankruptcy is the most significant drain on the HFCLIF to date, representing the majority of the $30.8 million that Cal-Mortgage has paid to date for troubled projects. The nearly $12 million in annual debt service and principal payments on the Triad bonds is expected to be mitigated this year by Triad's contribution of $3 million per year to bondholders. In addition to Triad, payments have been made for five other severely troubled projects totaling $2.3 million, including one project that is currently in Chapter 9 bankruptcy. Cal-Mortgage is actively working with management in each situation to minimize losses. Six other projects have invaded their debt service reserve funds as of January 1997. At this time, these six projects have adequate reserves to pay debt service.

The Future

Senate Bill 1705 and the memorandum of understanding agreements effectively addressed rating concerns stemming from previously undefined mechanisms of funding by the state. However, as more facilities experience financial hardships and seek assistance from the HFCLIF to help support debt obligations, the financial strength of the fund, and the ability of Cal-Mortgage to manage its portfolio, is more important in order for the program to continue to operate at no cost to the state. Although the most recent actuarial report confirmed the HFCLIF's adequacy to meet all "normal and expected" expenses, including the ongoing expense of the Triad default, the report questioned the fund's viability in the event of more significant changes in the health care environment through 2000 and beyond.

California Mortgage Program Rated Financings

California Health Facilities Authority Issues	Principal outstanding (mil. $)
Inglewood (Daniel Freeman Hospitals)	65.5
John C. Fremont Hospital District	5.8
Kern Valley Hospital District	19.5
Local Med. Fac. Fin. Auth. (pool)	9.7
Local Med. Fac. Fin. Auth. II (pool)	7.2
Local Med. Fac. Fin. Auth. III (pool)	3.1
Lodi Memorial Hospital Assn.	15.6
Lompoc Hospital District	6.5
Los Angeles Cnty. (Ararat Home)	6.2
Los Angeles Cnty. (Bay Harbor)	12.2
Los Angeles Cnty. (Behavioral Hlth. Services)	10.8
Los Angeles Cnty. (Children's Inst. International)	5.3
Los Angeles Cnty. (Ins. Hlth. Clinic prog.) ser. A-D	19.3
Los Angeles Cnty. (Ret. Hsg. Fnd.-Gold Country Hlth.-Mayflower Gardens)	13.1
Los Angeles Cnty. (San Pedro House (Beacon House Assoc.))	2.2
Los Angeles Cnty. (Solheim Lutheran Home)	7.9
Mayers Memorial Hospital District	8.6
Mendocino Coast Hospital District	4.0
Mill Vy. (Community Church Retirement Center (The Redwoods))	5.7
Modoc County SNF	2.0
Northern Kern/S. Tulare Hospital District	3.9
Oakland (East Oakland Hlth. Ctr. (W. Oakland Hlth. Council)	2.4
Oroville Hlth. Facilities (Oroville Hospital)	17.5
Palo Alto (Lytton Gardens Conv. Hospital)	13.3
Pasadena (Pacific Clinics)	5.0
Plumas Hospital District	0.9
Redbud Hospital District (Redbud Community Hospital)	4.8
Redlands (Redlands Community Hospital)	20.9
Redwood Easter Seal Society	3.6
Reedley (Sierra View Homes)	4.4
San Benito Hlth . Foundation	2.3
San Benito Hospital District (Hazel Hawkins Memorial Hospital)	8.0
San Francisco City & Cnty. (Irwin Memorial Blood Center)	8.0
San Gorgonio Memorial Hospital	8.1
Santa Barbara (American Baptist Homes of the West - Valle Verde)	11.3
Santa Barbara (FACT - Vista Del Monte)	20.9
Santa Barbara (Montecito Retirement (Casa Dorinda))	18.2
Santa Clara Cnty. (American Baptist Homes of the West-Terrace Los Gatos)	57.3
Santa Rosa (Episc. Homes Foundation-Spring Lake Village)	19.9
Selma Hospital District	4.3

California Health Facilities Authority Issues	Principal outstanding (mil. $)
Sierra View Local District Hospital	43.1
Sonoma Valley Hospital District	11.3
Tahoe Forest Hospital District	11.1
Tulare Local Hospital District	12.2
Upland (Sunset Haven)	6.0
Watsonville (Watsonville Community Hospital)	36.4
West Side Hospital District	4.7

California Mortgage Program Rated Financings

The challenge to the Cal-Mortgage program will be to balance its mission to provide credit enhancement to less established health care providers in underserved communities, with a need to manage the overall credit risk of the portfolio. As part of its ongoing evaluation of the program, Cal-Mortgage's management at the Office of Statewide Health Planning and Development continues to reassess the types of facilities that should receive new Cal-Mortgage guarantees. In the early years of the Cal-Mortgage program, the loan portfolio primarily consisted of acute care hospitals. In 1992 the Cal-Mortgage Plan called for a shift toward community-based primary care facilities, which now comprise a significant portion of insured projects. Most recently, Cal-Mortgage has insured more multi-level or continuing care retirement communities, although management continues to monitor changes in the health care environment and identify future program directions. In the long term, the success of the Cal-Mortgage program will depend on the credits themselves and on Cal-Mortgage's ability to actively manage and mitigate risk in the portfolio. However, from a credit standpoint, the ultimate strength of the Cal-Mortgage program is still the full faith and credit of California, which at this time offsets much of the risk inherent in the Cal-Mortgage program. CWM